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No. 440

Supreme Court of the United States

OCTOBER TERM, 1947

JOHN A. LAIRD, PETITIONER

v.

UNITED SHIPYARDS, INC., JOSEPH W. POWELL, HUBERT E. ROGERS, and THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK

PETITION FOR A WRIT OF CERTIORARI TO THE SECOND CIRCUIT COURT OF APPEALS

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This is a petition for a writ of certiorari to the Second Circuit Court of Appeals to review a decision (CHASE and CLARK, *CJJ.*, and RIFKIND, *DJ.*) affirming a judgment in the Southern District of New York (CONGER, *DJ.*) in favor of the defendants.

Petitioner, one of approximately 1,000 pre-organization purchasers of "when issued" stock of respondent United, sued on its derivation to recover for it $440,000 damages for deceit practiced by the other respondents under circumstances of aggravated corporate abuse set forth in the statement of facts. In this diversity suit, the District Court ignored the state rule that such deceit operates as an actionable injury to the corporation. Instead, the District Court applied a rule of pre-*Erie* federal common law that such deceit does not defraud the corporation and dismissed the complaint.

The Circuit Court of Appeals affirmed the holding of the District Court, under the "federal" rule, that

the complaint did not show fraud on the corporation. Any residual cause of action, for breach of fiduciary duty, held the court, would be barred by the state statute of limitations applicable to a cause of action of the last mentioned type.

In the state court the suit, sounding in deceit and commenced within a few months after petitioner's discovery of the facts, would have been timely.

QUESTIONS PRESENTED

1. Whether under *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64, and *Guaranty Trust Co.* v. *York*, 326 U. S. 99, a federal court may in a diversity suit ignore state law pursuant to which the pre-organization purchasers of when issued stock from promoters or bankers to whom it has been optioned are deemed original stockholders, so that deceit practiced on such purchasers constitutes fraud on the corporation.

2. Whether the court may hold that a complaint alleging such facts states only a case of breach of fiduciary duty, barred by the shorter statute of limitations applicable to a wrong of that kind.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals is reported at 163 F. (2d) 12. The opinion of the District Court, unreported, appears at pages 1230-1250 of the record.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered August 13, 1947 (R. 1280). The jurisdiction of

this court is invoked under § 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

STATEMENT OF FACTS

Respondents Powell and Rogers, with the assistance of the respondent The Chase, promoted United (R. 48-54, 118-122, 250), a New York corporation (R. 622), to acquire and combine six shipyards (R. 595-662, 779-87), including the properties of W. & A. Fletcher Co., in receivership (R. 727), which company owed The Chase over $700,000 (R. 874). To raise from the investing public the $9,000,000 necessary for the promotion, United, controlled by Powell and Rogers (R. 118-119), optioned (R. 1277) 450,000 shares of common stock (R. 707-13) to Albert H. Wiggin, chairman of the board of The Chase (R. 441), John E. Aldred and Richard F. Hoyt of Hayden, Stone & Co. (R. 183) through whom the shares were publicly offered (R. 743, 158). Prior to the offering, a syndicate (R. 747-8) formed by the bankers (R. 158) agreed with the bankers, but not with United, to take the shares if the bankers should exercise their option (R. 719-22).

The offering was made on a fraudulent prospectus (R. 711-13) which made it appear (R. 505-6) that options on the six properties were held by United and that the aggregate purchase price of $20,090,000 in cash and securities was to go to the named vendors, whereas in fact (1) the options on four of the properties were held by Powell and Rogers (R. 618-22, 636-51, 770-4, 121-2) and (2) the $20,090,000 included $440,000 in preferred stock to be received by Powell and Rogers as a bonus for participating in the financing to the extent of

$1,700,000 (R. 639, 649), which sum was loaned to them for the purpose by The Chase (R. 848). Powell, Rogers and Wiggin had knowledge of the prospectus and that it was to be used on the offering and Rogers approved it as attorney for United (R. 701, 710, 106, 134-5); and the bankers, including Wiggin, knew and approved of the bonus to be received by Powell and Rogers (R. 127, 137, 1237-8). Powell and Rogers admitted that no information regarding their receipt of the $440,000 par value of preferred stock was ever conveyed to the purchasers on the public offering (R. 106-8, 135-9).

The offering was oversubscribed (R. 1233, 536, 552-3), the entire issue being bought up by over 1,000 investors (919-20, 918), including your petitioner, who, induced by and in reliance on the prospectus and believing therefrom that United held the options and entirely unaware of the secret profits of the promoters (R. 477, 505-6), purchased 100 shares for $2,200 on January 15, 1929 (R. 753), the day of the offering (R. 413). On similar inducements (R. 538-40, 548-9, 591) another investor, Baker-Scott Corporation, since dissolved (R. 534), became a member of the syndicate (R. 722) and purchased 31,000 shares for $682,000 (R. 765-8), its subscription having been materially cut by the syndicate managers (R. 536, 719, 552-3).

On January 21, 1929, the selling price of the stock was collected (R. 164-5, 745) from your petitioner (R. 754, 759-60), from Baker-Scott (R. 177) and from the other purchasers, in exchange for interim receipts of The Chase (R. 755-6, 762, 764-5). Under these receipts, The Chase agreed to hold the fund for the security of the receipt holders, to pay out of it $9,000,000 to United in exchange for the 450,000 shares and the balance of

$900,000 to the bankers for their profit, and on surrender of the receipts, to distribute the stock, or if the deal should not go through, to refund the subscription money (R. 715-18, 755). Under date of January 15, 1929 the bankers had ordered United, subject to exercise of the option, to deliver the 450,000 shares to The Chase as depositary under the interim receipt agreement (R. 830).

The closing took place on February 28, 1929 at the offices of The Chase Securities Corporation (R. 222-3). Up to that time, the option on the 450,000 shares had not been exercised. Now, however, The Chase, from the deposited funds, paid the $9,000,000 to United out of which sum, United's entire cash capital (R. 712), the six properties were acquired (R. 894) and United issued the 450,000 shares to The Chase as depositary as aforesaid (R. 1234, 830-833).

At the closing, Powell and Rogers borrowed the $1,700,000 from The Chase in its capacity as a commercial bank (R. 848), participated in the financing and received their bonus of $440,000 par value of preferred stock (R. 143, 834), worth on that date at least $440,000 (R. 774, 824-5).[1]

Instead of immediately offering to deliver the 450,000 shares to your petitioner and to the other interim receipt holders as it was obliged to do (717, 755), The Chase, on an indemnity agreement signed by Rogers as secretary of United (R. 881-3), held the stock

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[1] This was in addition to the $60,000 cash which Powell and Rogers received from the corporation to cover their promotional and legal services (R. 124-5) and $34,895.80 received by them as participants in the banking syndicates and selling group (R. 748, 752).

from February 28th until April 17th (R. 941-5), in the meantime giving to the promoters a proxy (R. 928) thereon which Rogers, general counsel for United (R. 120, 122), used at a meeting of "stockholders" held April 3, 1929, to vote the stock in favor of a resolution ratifying the promoters' bonus (R. 939-40, 261-2). This meeting was held without notice to your petitioner or to any of the other interim receipt holders (R. 925, 833-4, 262-4).

A few months after discovering the facts (R. 513), in 1940, and after an unsuccessful attempt to obtain an audit of the transactions between the management (Rogers, president) and the corporation (R. 1226-8), your petitioner, an attorney and counsellor of New Jersey (R. 477, 512), commenced this suit in the Southern District of New York, alleging diversity of citizenship as the basis of the jurisdiction of the court as a federal court (R. 4, 46.12).

Deceit was specifically alleged in the terms referred to in *Reno* v. *Bull*, 226 N. Y. 546, 550, *viz.*, (1) representation and falsity in the prospectus, (2) *scienter* by the defendants, (3) deception of the purchasers in general and of petitioner and of Baker-Scott Corp. in particular, and (4) injury in that the $440,000 par value of preferred stock was issued to Powell and Rogers without consideration (amended complaint, paragraphs 10, 39-42, 44-56, 62, 63(d), 71, 72; R. 46.15-16, 46.25-30, 46.33-35).

During the trial, the District Judge thus stated the issue (R. 131):

> "It is not a question of defrauding these two plaintiffs in the sale of stock * * *
>
> The real issue is whether or not the corporation was defrauded, * * *."

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

(1) In failing to hold that the original holders of the 450,000 shares were petitioner and the other holders of the interim receipts at the time of the closing on February 28, 1929.

(2) In failing to hold that the deceit practiced on petitioner and on the other holders of the interim receipts at the time of the closing on February 28, 1929 constituted deceit on United.

(3) In failing to hold that the suit, having been commenced less than six years after petitioner's discovery of the facts, was not barred by limitation.

(4) In holding that the original holders of the 450,000 shares were the bankers.

(5) In holding that at the time of the closing, all parties then having an interest in United were fully aware of all the facts.

(6) In holding that the cause of action asserted by petitioner was a cause of action for breach of fiduciary duty to United.

(7) In holding that the suit was barred by the New York statute of limitations.

REASONS FOR GRANTING THE WRIT

In clear contravention of the doctrine of *Erie Railroad Co.* v. *Tompkins, supra,* the decision below frustrates the salutary rule of state common law that a corporation suffers actionable wrong when the pre-organization purchasers of its stock are deceived by promoters or bankers who sell the shares "when issued". Un-

der the so-called "federal" rule, disapproved by this Court in *McCandless* v. *Furland*, 296 U. S. 140, but nevertheless applied in the decision below, the corporation may not recover, however gross the fraud.

That deceit practiced in securing subscriptions to the original capital of a corporation constitutes deceit in its organization, for which the corporation may recover, has been recognized by both state and federal courts. See, *e.g.*, *Colton Improvement Co.* v. *Richter*, 26 Misc. 26; *Crowe* v. *Malba Land Co.*, 76 Misc. 676; *Davis* v. *Las Ovas Co.*, 227 U. S. 80.[2] But where as here such capital is raised by optioning its original stock to bankers, who prior to organization of the corporation sell the shares "when issued"—that is to say, sell their option right to receive the stock on its original issuance, a conflict of authority obtains as to whether the corporation is bound by the bankers' consent to promoters' profits concealed from the purchasers.

In 1923 the Second Circuit Court of Appeals laid down the rule that the corporation is so bound in *Ball* v. *Bond, Elliott & Harrison*, 294 Fed. 227,[3] which case

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[2] If all of the stockholders agree to the basis of organization, however inflated, subsequent purchasers of the stock from the incorporators cannot successfully contend that the corporation was deceived by what the organizers agreed to. *Blum* v. *Whitney*, 185 N. Y. 232; *Seymour* v. *Spring Forest Cemetery Ass'n*, 144 N. Y. 333, 340.

[3] "Appellant puts forward the theory that, because of the dealings with the syndicate and the dealings of members of the syndicate with the public prior to incorporation, therefore both the public and the syndicate members were equitable stockholders at the time of the transactions complained of. This theory is characterized by ingenuity rather than by substance, and in our view does not invite discussion." (294 Fed. pp. 232-3; *cert.* den. 264 U. S. 584)

was followed in the Third and Seventh Circuits in *South Penn Collieries Co.* v. *Sproul,* 52 F. (2d) 557, 559-60 and *Ball* v. *Chapman,* 1 F. (2d) 895, respectively, and reaffirmed by the Second Circuit in *McCandless* v. *Furlaud,* 75 F. (2d) 977, 978-80.

In reversing the decision of the Second Circuit in the *McCandless* case,[4] this Court clearly foreshadowed ultimate rejection of the *Ball* rule. Pointing out the fictional quality of the consent of those who market when issued securities, this Court said, per CARDOZO, *J.*:

> "This is not a case where at the time of issuing the securities the shareholders and the promoters were the only ones concerned. * * * The promoters could not receive for themselves or deliver to subscribers the bonds and notes of the company secured by deed of trust until title had been acquired to the lands covered by the deed. On the other hand, they could not pay the purchase price and acquire title to the lands without the proceeds of subscriptions, the contributions of the public" (296 U. S. pp. 159-160).

Referring to the purchasers on the public offering, this court held:

> "Here at the moment of conveyance the interests of bondholders and noteholders were put in jeopardy * * *."

The state courts never adopted the legalistic and oppressive doctrine of the *Ball* case. On the contrary un-

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[4] There the when issued securities were bonds, not stock, and the reversal was on the broad ground that no stockholder's consent could bar the rights of creditors. However, this court expressly reserved judgment on the question

> "whether the corporation itself at the instance of new shareholders would be permitted to disaffirm the fraud and maintain a suit in equity for appropriate relief." (296 U. S. p. 160)

der New York law and under the law of every other state in which the question has been passed on, petitioner and the other holders of the interim receipts, despite the fact that they purchased from the bankers, were the original holders of the 450,000 shares and deceit practiced on them was deceit in the organization of United, for which it may recover. *Midwood Park Co.* v. *Baker,* 128 N. Y. Supp. 954, affd 144 App. Div. 939, affd 207 N. Y. 675; *Hyde Park Terrace Co.* v. *Jackson Bros. Realty Co.,* 161 App. Div. 699; *Arnold* v. *Searing,* 73 N. J. Eq. 262, 264-6; *California-Calaveras Mining Co.* v. *Walls,* 170 Cal. 285, 301; *Pittsburgh Mining Co.* v. *Spooner,* 74 Wisc. 307, 320-4; *Birbeck* v. *American Toll Bridge Co.,* 23 Del. Ch. 83, 95-6; *Nye Odorless Incinerator Corp.* v. *Felton,* 35 Del. 236.

In the *Midwood Park Co.* case as here the promoters obtained options on property, concealed the option price and caused a new corporation to agree to purchase the property at a higher figure, payable in cash and securities. With money subscribed for the securities by innocent parties, the promoters bought the property and conveyed it to the corporation, in consideration for which the securities were issued to the promoters and then transferred to the subscribers. As in the case at bar, the promoters there argued that the corporation had not been defrauded. Reaching a result which the courts below refused to follow in this case, the New York courts brushed aside all arguments based on the form of the transaction.[5] Holding that the corporation had been defrauded, the trial court said:

"The minutes of the incorporators and directors of

[5] The foregoing appears in part from the opinion in 128 N. Y. Supp. and in part from the findings, excerpts from which are set forth in Appendix I to this petition.

> the Kouwenhoven Company at the time of its organization, the exact phraseology of the resolutions approving the manipulations of Messrs. McLauchlin and Herd, by which it was sought to put $202,000 into their pockets without the knowledge of their associates, and without the expenditure of a dollar on their part, are of no avail. Equity cuts through all this legerdemain and lays bare the facts." (128 N. Y. Supp. p. 956)

The *Hyde Park Terrace Co.* case is another decision wherein the New York courts gave relief to a corporation for deceit practiced by the incorporators on the subscribers where the stock

> "was issued to the incorporators and distributed to the subscribers" (161 App. Div. p. 700).

In *Arnold* v. *Searing,* the Vice-Chancellor ruled:

> "The injury to complainants through the false representations made by defendants, was, in my judgment, an injury to them in their corporate rights." (73 N. J. Eq. p. 267)

In *Pittsburgh Mining Co.* v. *Spooner,* the Supreme Court of Wisconsin held:

> "The fraud in the sale was therefore a fraud upon the collective interests of the shareholders * * *." (74 Wisc. pp. 323-4)

Compare *Hutchinson* v. *Simpson*, 92 App. Div. 382, where bankers contracted to sell property to a new corporation in exchange for its stock. The bankers then sold part of the stock, when issued, on a prospectus which disclosed the above, but not the extent of their profit. A divided court refused to permit the plaintiff, who had purchased his stock from the bankers, to assail on behalf of the corporation the transaction whereby the bankers acquired the stock. Settled pending appeal to the New York Court of Appeals, the case has never been cited by that court. In the case at bar, on the contrary, the profit attacked arose not from the bankers' option on the 450,000 shares but out of independent transactions between Powell and Rogers, the vendor companies and United.

In *California-Calaveras Mining Co.* v. *Walls,* the Supreme Court of California reasoned:

> "* * * to the extent that these stockholders, through the fraudulent conduct of Manson, were injured, it was an injury to the corporation as representing their collective or corporate interests." (170 Cal. p. 301)

And of the leading case of *Erlanger* v. *New Sombrero Phosphate Co.,* 3 App. Cas. 1218, *Morawetz* (2d ed. p. 279) said:

> "The fraud really consisted in inducing the shareholders to enter into this contract in their collective capacity, and in using the funds belonging to the shareholders collectively in paying the purchase price. It is evident, therefore, that the injury to the shareholders was an injury to their collective or corporate interests, and that the company was the proper complainant."

In deciding the underlying question in this case, who were the original holders of the 450,000 shares, petitioner and the other deceived purchasers or the acquiescing bankers, the District Court ignored the salutary rule of state law above set forth, as well as its own finding (R. 1267) that for purposes of Federal Rule 23(b) petitioner was a shareholder at the time of the transaction complained of. Instead, expressly following the *Ball* doctrine and citing that and the *South Penn Collieries Co.* cases as authority, the court reached the wholly unrealistic, inequitable and inconsistent result that petitioner and the other deceived purchasers who, by their pre-organization subscriptions, had supplied United with its entire cash capital of $9,000,000, had no interest in the corporation at the time of its organization. On the contrary, although the bankers had sold

out a month and a half before their option on the 450,000 shares was exercised with the money deposited by petitioner and the other purchasers, the bankers remained the original stockholders, held the court. The bankers' consent, it was adjudged, bound United and as a matter of law precluded deceit practiced on the purchasers from operating as actionable injury to the corporation.[6]

This holding was in a real sense the turning point of the decision of the Circuit Court of Appeals, not the

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[6] Judge Conger stated in his opinion (R. 1237-40):

"Assuming the most favorable facts to the plaintiff, that there was a secret profit, in the sense that the profit was not disclosed to the public, the plaintiff must fail in the light of the facts of this case. There was a disclosure to every interested party when the transactions took place and they acquiesced in them. The only parties interested on February 28, 1929 were the vendors, the bankers and the corporation. There was a full disclosure to all."

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"In *Ball* v. *Breed, Elliott & Harrison*, 294 F. 227, • • • there were persons who had contracted to purchase stock when the transactions complained of occurred. There, as here, the contracts were with the bankers and not the corporation. The argument was advanced, as it has been here, that because of the prior dealings with the public by the members of the syndicate the public and the syndicate members became equitable stockholders at the time of the transactions complained of. The court held that all those in interest were informed and rejected the argument as to their being equitable stockholders. See also, *South Penn Collieries Co.* v. *Sproul*, 52 F. 2d 557; *Arn* v. *Dunnett*, 93 F. 2d 634.

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"I conclude from a reading of the cases that the turning point is whether the plaintiff is an original subscriber

statute of limitations.[7] Aside from *res judicata* and the effect of the reorganization,[8] questions not dealt with in its opinion, the sole issue in that court was who were the original holders of the 450,000 shares and was United deceived. Petitioner has always conceded that if he and the other purchasers were not original stockholders, the deceit practiced on them resulted in no actionable wrong to United. Respondents have never denied that if petitioner and the other purchasers were original stockholders, the discovery provision of the statute of limitations applied. And under that provi-

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of stock or not, for if he is there must be a disclosure to him. But where one is not an original subscriber but buys through a broker or banker, the corporation is not a party to that transaction. A cause of action for any wrong in that situation lies against the seller by the buyer.

"In the case at bar Laird was not an original subscriber. He bought his stock through the bankers. I, therefore, hold that the disclosures made by Powell and Rogers to the vendors, the bankers and the corporation and their acquiescence in the transactions bar this suit on the Crane and Shewan transactions."

[7] The opinion of the Circuit Court of Appeals contains the puzzling statement that

"There was no allegation or proof of fraud of the kind which is found in *Reno* v. *Bull*, 226 N. Y. 546, 550." (R. 1279)

In view of the clear allegation and proof of deceit practiced in the sale of the 450,000 shares to petitioner and the other purchasers, the statement can be given meaning only by reference to the District Court's erroneous holding of substantive law that the acquiescing bankers, not petitioner and the other deceived purchasers, were the original holders of that stock.

[8] For a brief statement of petitioner's position on these points, see Appendix II to this petition.

sion the suit was clearly timely, having been instituted after discovery of the facts within a few months out of the six years allowed by §48(5) of the New York Civil Practice Act for the commencement of such suits.

And so the Circuit Court of Appeals, after quoting (R. 1278) from the District Court's findings, concluded that the complaint did not state a cause of action for deceit against United since

> "'The said 4,400 shares of United Preferred were issued * * * with knowledge by all of the parties then interested in United * * *'"

i.e., the bankers, the vendor companies and the management. Any residual cause of action, for breach of duty and not for deceit, since

> "all parties then having any interest in, or holding any position of responsibility to, the corporation were fully aware of all the facts" (R. 1279),

accrued, held the court, on February 28, 1929 and was barred before this suit was commenced.[9]

Thus the courts below decided the fundamental question of substantive law in this case, who were the original holders of the 450,000 shares, petitioner and the other deceived holders of the interim receipts or the ac-

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[9] The mentioned provisions of the New York Civil Practice Act are set forth in Appendix III to this petition.

Hastings v. *Byllesby & Co.*, 293 N. Y. 404, and *Lever* v. *Guaranty Trust Co.*, 289 N. Y. 615, simply stand for the proposition, never contested by petitioner, that § 48(5) applies only to cases of deceit, not to cases of constructive fraud. In the *Hastings* case, the gravamen of the complaint was the use by the defendants of their control of an existing corporation to cause it to buy and sell securities at prices unfavorable to the corporation and yielding large profits to the fiduciaries (293 N. Y. pp. 408-9) Facts constituting deceit were not alleged.

quiescing bankers, pursuant to their own 1923 rule and contrary to the common law of the State of New York. As a result, the Circuit Court of Appeals held barred by limitation this suit, maintainable in the state courts as seasonably commenced within the provisions pertaining to cases of deceit. While paying lip service to *Erie Railroad Co.* v. *Tompkins* by stating that under *Guaranty Trust Company* v. *York* the state statute of limitations should be followed, the Circuit Court of Appeals effectively nullified the *Erie* rule and the state law applicable thereunder.

The importance of the *Erie* rule as a guide to the distribution of judicial power between the state and federal governments need not be stressed in this Court. As has been recently stated, a "policy so important to our federalism" must be "applied with an eye alert to essentials in avoiding disregard of State law in diversity cases in the federal courts";[10] and such a policy must be protected against unexpressed and perhaps unintentional encroachment, with which it is so much more apt to be assailed than with deliberate and avowed disregard.

Likewise, in the *Lever* case, the cause of action was for using the defendants' control of the corporation to cause it to pay their obligation (289 N. Y. pp. 616-18).

In *Mannaberg* v. *Klausner*, 294 N. Y. 859, it was held that a cause of action for breach of duty perpetrated by deceit by one joint adventurer against others, among whom a fiduciary relationship existed, is subject to the discovery provision of § 48(5). To the same effect, see *Brundige* v. *Bradley*, 294 N. Y. 345, 349.

[10] *Guaranty Trust Co.* v. *York*, 326 U. S. 99, 110.

But if illustration be desired, the broadly remedial nature of the state law here ignored illustrates the significance of the *Erie* rule as part of our constitutional system. Under the case at bar, and under the line of lower federal court decisions to which it gives new life and importance, a corporation has no redress for fraud, no matter how gross, committed in its promotion, if its original shares are optioned to the promoters or bankers who market such shares and if these distributors of securities acquiesce. Pronounced by the federal courts in New York, financial center of the country, the decision frustrates, at least to the extent that diversity jurisdiction may be invoked through removal, a salutary rule of state common law under which such a corporation is held to have sustained actionable wrong. It would be in the public interest to prevent that abuse of federal jurisdiction even if such abuse were not, under the *Erie* doctrine, unconstitutional.

And unless made necessary by a compelling rule of law, found directly applicable after the fullest review, the flagrantly corrupt and illegal conduct by corporate insiders disclosed in this case ought not to go without remedy in the national courts.

CONCLUSION

It is respectfully submitted that this petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

JOHN A. LAIRD,
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Counsel for Petitioner.

APPENDIX I

Excerpts from findings of fact and conclusions of law of the court in *Midwood Park Co.* v. *Baker*, 128 N. Y. Supp. 954.

"57. On the 1st day of May, 1906, the first meeting of the incorporators named in the certificate of incorporation of the defendant Kouwenhoven Realty & Improvement Company was held, and at the said meeting a proposition was submitted by said Anderson T. Herd, which is in the words and figures following:

To the President and Board of Directors
Kouwenhoven Realty & Improvement Co.

Gentlemen:

I propose to sell and agree to have conveyed to the Kouwenhoven Realty & Improvement Company two certain tracts of land located in the Borough of Brooklyn, County of Kings, and City of New York, lying in Sections 15, 23 and 24 on the Land Map of Kings County, two tracts of land.

One known as the Wyckoff Farm, containing 42 acres and 773/1000 acres, fully described by metes and bounds on plot attached to this proposition.

The other tract of land containing 176 acres and 439/1000 acres, is what is known as the Cornelius B. Kouwenhoven Farm, the tracts lying adjacent to each other. Certain rights of way acquired by the Long Island Railroad, in the City of New York, it will be observed, with several other minor reservations, are not to be included. A plot of the Kouwenhoven tract, duly surveyed, is likewise attached to this proposition of sale, both tracts being described by metes and bounds and to be described by metes and bounds in the conveyance to you.

Your Capital Stock, I understand, is $650,000. I propose that $216,000 of the par value of this stock be retained in your Treasury for the making of improvements in the way of streets, sidewalks, curbs, planting of trees, if desired.

That you shall turn over to me the remainder of said stock, amounting to $434,015.22, or cash for the same at par, excepting so much of the same as

is now being subscribed and paid for, which said sums shall be now applied toward the payment of the property in taking title.

The Kouwenhoven Realty & Improvement Company takes title subject to five mortgages, two for $356,941.98 and $1,949, respectively, resting on the Kouwenhoven tract; two for $93,000 and $8,051, respectively, resting on the Wyckoff tract, and one for $202,102.80, resting upon both tracts, making a total of $662,044.78, which, with the $434,015.22 of the Capital Stock, will make the purchase price of the property, namely $1,096,060.

Respectfully submitted,
ANDERSON T. HERD.

The said incorporators then and there passed a resolution, which is in the words and figures following:

WHEREAS, This Company was incorporated under the laws of the state of New York for the purpose set forth in the Certificate of Incorporation:

WHEREAS, It was the intention of the incorporators, among other things to purchase and take over the property mentioned in said proposal; and

WHEREAS, The said Herd has made a proposition for the sale of said property to this corporation for the sum mentioned in said proposition; and

WHEREAS, It appears, after due consideration and investigation that it is necessary and advantageous for the best interests of this Company that it acquire, purchase and take over said property and make the payments therein called for:

NOW, THEREFORE, BE IT RESOLVED, That this Company do purchase the said property for the sum mentioned in said proposition and pay for the property described in said proposition the sums therein specified and at the times therein mentioned, and that the said Company does hereby fully accept all the terms and conditions set forth in said proposition; and

BE IT FURTHER RESOLVED, That the aforesaid proposition, together with a copy of this Resolution, be referred to the Board of Directors, and we hereby authorize and instruct our said Board of Directors to perfect the acquisition and purchase of said property therein described, provided that the judgment of the Board of Directors of this Company concur in our opinion of the value of the property to be purchased."

* * * * * *

"60. On the 2nd day of May, 1906, the directors named in the certificate of incorporation for the first year of the Kouwenhoven Realty & Improvement Company met, when four of them resigned and Aaron McNeill, James M. Potter, Peter Brooks and Charles B. Wing, the latter two of whom were members of the syndicate, Exhibit F, were duly elected in their places.

The majority of said Board of Directors was composed of the servants, agents and employees of the said Anderson T. Herd and Charles W. Baker, and was under the absolute control and dictation of said Anderson T. Herd and Charles W. Baker and did not exercise an independent judgment."

"61. Anderson T. Herd was present at the said meetings of incorporators and directors held on the 1st and 2nd of May, 1906, respectively, dominating and controlling the proceedings, prepared the minutes and secured the passage of a resolution accepting his said proposition theretofore submitted to and accepted by the incorporators and which was received in evidence and marked Exhibit R2.

"62. Neither the said Anderson T. Herd nor Charles W. Baker, nor any person on their behalf, disclosed at said meeting of directors on the 2nd of May, 1906, the fact of their interest in the contracts between Midwood Park Company and Brooklyn Realty Trading Company and Bertha G. McLaughlin and Anderson T. Herd for the purchase of the Kouwenhoven and Wyckoff tracts at the sum of $2,750 and $3,150 per acre, respectively,

but the said Anderson T. Herd and Charles W. Baker concealed and suppressed the truth as to their connection with and interest in said contracts."

The foregoing excerpts appear at pp. 65-69 of the record on appeal to the New York Court of Appeals (203 N. Y. 545). Other portions of the decision of the court dealing with the promoters' secret profit are findings 22-24, record pp. 46-54; findings 42, 43, 45, 47, 48, 50-55, 58, 62-65, 67-71, 77-85, record pp. 61-77; conclusion of law 11, record p. 85.

APPENDIX II

District Court's Alternative Grounds of Decision

In addition to the holding that deceit practiced on petitioner and the other purchasers on the public offering did not constitute fraud on United because they were not original stockholders, the District Court placed its judgment on the following further grounds: (1) that the cause of action asserted by petitioner was vested in the debtor in possession in the § 77B proceedings and that the reorganized debtor, although the same corporation, is a separate entity from the debtor in possession and is not now vested with the cause of action (R. 1246-8); (2) that since the cause of action now asserted could have been interposed by United to defeat the claims of Powell and Rogers in the reorganization, allowance of their claims renders this cause of action *res judicata* (R. 1249-50). In view of the limited scope of the decision of the Circuit Court of Appeals, no detailed statement of petitioner's position on these points is here attempted.

Briefly, however, if this court reverses on the question of fraud, so that the statute of limitations does not bar the suit, petitioner and United would be entitled to a reversal in the Circuit Court of Appeals on the District Court's further grounds because: (1) Where, as here (R. 1026), no trustee is appointed, the bankrupt is not divested of its assets, *Danciger* v. *Smith*, 276 U. S. 542. But even if a trustee had been appointed, confirmation (R. 1204-5) of the plan would have revested the debtor. See § 70(f) of the Bankruptcy Act of 1898, 30 Stat. 566, effective in 1936 when United's plan was confirmed, also present § 70(i). See also *Meyer* v. *Fleming*, 327 U. S. 161. (2) Since the issues in this suit are different from those litigated on proof of the claims of Powell and Rogers in the reorganization, the cause of action in this suit is not *res judicata* by reason of the allowance of claims in those proceedings even though if disclosed and interposed in the reorganization, the cause of action would have constituted a defense to such claims. Restatement of Judgments, § 68 (2); *Weinert* v. *Kinkel*, 269 App. Div. 401, affd N. Y. 151; *Virginia-Carolina Chemical Co.* v. *Kirven*, 215 U. S. 252, 257-9.

APPENDIX III

Statute of Limitations

As amended by N. Y. Laws of 1939, c. 359, § 2, N. Y. Civil Practice Act, § 48 provided:

> "The following actions must be commenced within six years after the cause of action has accrued:
>
> • • • • • •
>
> "*5. An action to procure a judgment on the ground of fraud.* The cause of action in such case is not deemed to have accrued until the discovery by the plaintiff, or the person under whom he claims, of the facts constituting the fraud."

For this purpose, knowledge of the wrongdoing directors is not imputed to the corporation. *Hifler* v. *Calmac Oil & Gas Corp.*, 258 App. Div. 78, 90; *Goldberg* v. *Berry*, 231 App. Div. 165, 170; *Brinkerhoff* v. *Roosevelt*, 143 Fed. 478, 483, *cert.* den. 200 U. S. 622. See also *Mencher* v. *Richards*, 256 App. Div. 280, 282; *Pollack* v. *Warner Bros. Pictures, Inc.*, 36 N. Y. Supp. (2d) 681, 684, modified 266 App. Div. 118; *Loughman* v. *Pitz*, 36 F. Supp. 302, 305; *Colton Improvement Co.* v. *Richter*, 26 Misc. 26, 31.

The ten year statute of limitations, relied on in the Circuit Court of Appeals by respondents and apparently applied by the court is as follows:

> "§53. *Limitation where none specially prescribed.* An action, the limitation of which is not specifically prescribed in this article must be commenced within ten years after the cause of action accrues." (N. Y. Civil Practice Act).